

Enquiry 2: Are customers demanding?

1 Why become a customer?

How do people spend their money?

Item	%
Housing, fuel and power	9
Food	11
Clothing and footwear	6
Transport	15
Restaurants and hotels	9
Household goods and services	7
Communication	3
Recreation and culture	14
Alcohol and tobacco	3
Other goods and services	23

Figure M1.3

Source: ONS, Social Trends, 2004

A

Your agenda

- 1 In 2003 the average family was earning £406.60 per week after tax. Work out how much they spent on each item in the list in Figure M1.3.
- 2 Reorganise the list into rank order so that the largest item of expenditure comes first and the smallest comes last.
- 3 Explain the variations between the amount spent on each item on the list. Make a list of your reasons.
- 4 Use your list to create categories to explain spending patterns.
- 5 Put the following items into the categories: a trip to the cinema, a carton of milk, a pair of shoes, a pad of file paper, a CD, a bus pass.
- 6 You created the spending categories and decided what went into them. Why might other people have different items in their categories? Give some examples.

Meeting the needs ...

We can rarely have everything we want. The data in Figure M1.3 show where the bulk of people's money goes. The highest proportion of spending is on necessities that we cannot do without – housing, food, power, etc. The remainder of our income is spent on the wants, or luxuries, that we can afford.

As few people can afford everything, we all have to choose. There are choices to be made at every level. Think of the decisions that have to be made about housing, the choice of food in the supermarket, or which pair of shoes to buy. The poorest in society have hard choices to make in order to meet basic needs. The more affluent regard many things as essential and may only have to choose between a range of luxuries.

... and the wants

What shall we do tonight?

Scene: a phone call on Saturday afternoon

NICK: Hi Sam, it's Nick. Got any plans for tonight?



SAM: Thought we might go to that new club. There were handouts at college. Did you see them?

NICK: I don't know if I can afford it. I've got to pay for that Economics and Business Conference next week. How much is it?

SAM: I'll just have a look on the leaflet. Here it is – its usually a fiver, but there is a special opening offer of two for the price of one with this voucher.

NICK: I couldn't manage a fiver, but £2.50 is just about OK. Are there no parties on anywhere? That would be even cheaper.

SAM: There's the film that won all the Oscars at the new multiplex. Its really cool there – but I always want a tub of popcorn and a coke. It's hard to get out without spending ten quid. Course, its cheaper at the old cinema in town, but there still wouldn't be much change from a fiver. If

only the price were lower, I'd go every week. There are so many good films on at the moment.

SAM: So what are we going to do Nick? We'll have to choose.

NICK: Well Sam, if we go to the club, I'll have a bit of money left for a night out during the week. If I do anything else, I'll be stuck at home all week. I could get that piece of portfolio work done, I suppose! Oh let's go clubbing, then at least I'm free to choose during the week.

SAM: Sounds good to me. I'll come round about eight.

Your agenda



- 1 Why did the new club offer half-price vouchers to potential customers?
- 2 What might happen if the club raised the price to £7.50 or lowered it to £2.50? Draw a simple line graph to show what might happen at different prices.
- 3 Is this pattern common to other products or services that people buy?
- 4 If Nick goes to either cinema, what does he have to give up? How does this affect his choice?
- 5 Why do some people opt to go to the multiplex rather than the older local cinema?

Nick and Sam have a choice on their hands. Like most students, they have a limited amount of money to spend and want to make the most of it.

Their decision involves selecting the best option from two or more choices or opportunities. They are seeking the best decision. In making this choice the next best opportunity has to be given up. The value of this next-best-opportunity is called the **opportunity cost** of a decision. If Nick and Sam had opted for the local cinema, the club and an outing during the week would have had to be given up. This was too much! The decision was therefore made to go to the club.

This principle has applications in every situation. The search for the optimum choice is made many times a day by people in business, in government and on their own behalf. Every decision is

determined by identifying the opportunity cost of choices in order to seek the best solution.

The need to choose arises because there is never enough to go round. If we all got everything we wanted, the world would soon run out of resources. This **scarcity** of resources has been overcome by the development of money and price which determines how much people can have.

In making choices, there are **trade-offs**. If you decide to go on a fortnight's holiday rather than buy a car, you have traded the gains from a holiday for a year of personal transport. If you decide to go for a week's holiday and buy an older car instead, you are making a trade-off between the two. People, businesses and governments all have to make trade-offs when they make decisions.

Essentials



The **opportunity cost** of a decision is the value expected to be derived from the next best decision. By making a choice, you make the opportunity cost of your actions clear.

Essentials



The **scarcity** of resources means that people cannot have all they want. As a result most resources are allocated according to the amount that people are able or prepared to pay.

Essentials



Trade-offs occur when two things cannot be fully achieved. The more you have of one, the less you can have of another.

Demand: making wants real

The desire to buy goods or services is called **demand**. In effect, this is an open request to other members of society, asking for our particular desires to be fulfilled. But since other people are unlikely to give us their resources for nothing, demand only becomes **effective demand** when backed by money.

Nick and Sam turned their wants into reality when they parted with £2.50 each to go to the new club. They were not prepared to spend £5 each, but other people might have been. If the price was lower than £2.50, many more people, who put a lower value on clubbing, might have gone as well.

Essentials

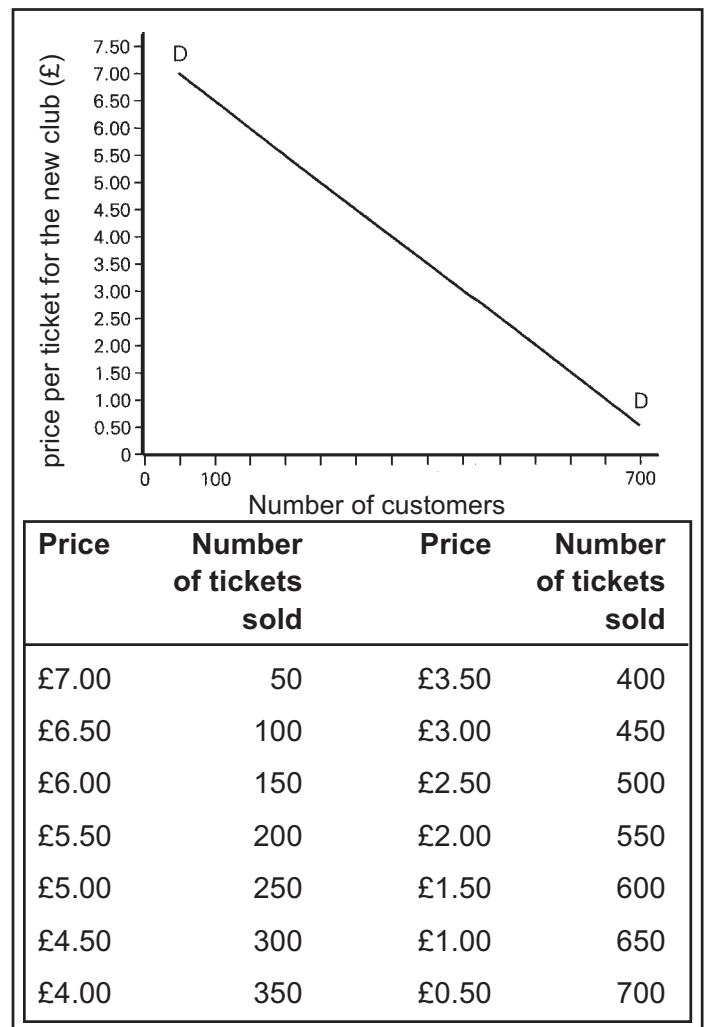


Demand means any want directed towards a particular good or service. It cannot be put into action unless it is backed by money or other items of value which might be used to exchange. Then it becomes effective demand.

For most things that are available in shops, as the price falls, people will buy more because they feel that they are receiving more benefit from spending their money in this way, rather than any other. As the

price falls, the opportunity cost falls because they have to give up less in order to make this purchase.

Even at a high price there are often some people who feel that the benefit they receive is worth paying for. As the price falls, an increasing number of people enter the market and start to buy. So the **demand curve** is downward sloping. Demand curves help in the analysis of how people behave in response to price changes. Figure M1.4 shows the result.



M1.4 Demand for tickets at the new club

Demand can be measured for an individual. A more useful measure is known as market demand because it shows how purchasers in general will respond to different prices. It is produced by adding together all the individual demand. Figure M1.4 is a market demand curve because it shows the demand for everyone, not just for Nick or Sam.

Essentials



The **demand curve** shows how much people are prepared to buy at a range of prices.

Work in progress



- 4 A price change will affect the demand for some products more than others. Identify those whose demand will be relatively unaffected, and those which will be affected a great deal. Is there any pattern?

Price £	Quantity demanded per year
15	5
10	10
5	15

- 1 The data in Figure M1.5 show Sam's demand for CDs at different prices. Plot his individual demand curve.
- 2 Will most people react similarly to a change in the price of CDs?
- 3 What is the market demand curve likely to look like?

Figure M1.5 Demand for CDs

2 What causes the demand curve to shift?

When spending power increases ...

'Hi Sam, it's Nick here. I've got a job! There was a notice in the book-shop window saying they needed part-time help, so I went in to find out more. It's just Saturday and some Sunday afternoons. It doesn't pay a lot but at least it means that I've a bit more to spend.'

Your agenda



- 1 What effect is the job likely to have on Nick's demand curve for cinema tickets? Draw a diagram to show what has happened:
- 2 What else is likely to change demand in this way?
- 3 What sort of things are unlikely to be affected by a change in income?

The amount that people have to spend usually determines how they use their money. An increase in income may change the pattern. Things that they couldn't afford now become a possibility. More people will be prepared to buy CDs, for example, as their income rises. What effect will this have on the demand curve?

The new curve (see Figure M1.6) has shifted to the right and shows that at any particular price more CDs will be sold. Of course, if incomes fall, the curve will shift to the left, showing that fewer will be sold at each price.

The same movement takes place if there are other changes that affect demand. Fashion is an important influence. Once people only bought Levi jeans if they needed them for heavy works. Then they became the ultimate fashion item. Now they are a standard in many wardrobes, but have been copied at both the top and bottom of the market. As the fashion fades, the demand curve may return to its former position.

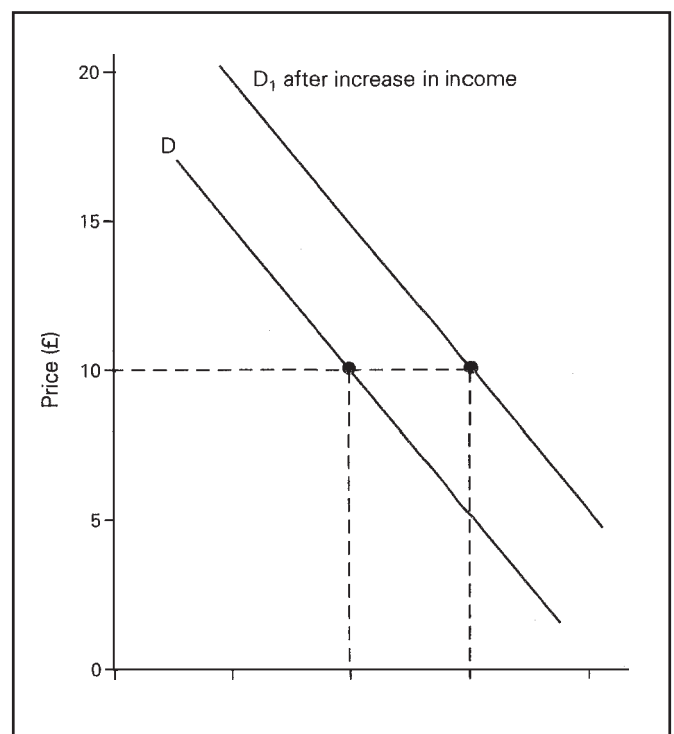


Figure M1.6. A shift in the market demand curve for CDs

Some very simple factors will shift the curve. Try looking for ice-cream in the newsagent's ice-cream cabinet on the first day of the year that the temperature rises above 20°C! Ice-cream firms try to anticipate change but they often misjudge the moment.

The demand for a product may also be closely related to the price of something else. If the price of petrol rose to £2 a litre, people might think twice about buying a car and might increase their demand for public transport. The demand curve for cars would, therefore, shift to the left while the demand curve for buses and train travel would shift to the right. Petrol and cars are known as **complementary goods** and cars and trains are **substitutes**. Indeed, all sorts of things make the demand curve shift. Health scares can cut demand for certain food products, while hot weather can boost ice-cream sales.

Essentials



Complementary goods are used together, so if the price of one rises, demand for the other will fall.

Essentials



Substitutes can be used to replace each other, so if the price of one rises, demand for the other will rise.

Work in progress



- 1 Can you identify some products which respond more than others to a change in income?
- 2 List three pairs of complements and three pairs of substitutes.
- 3 What products are, at the moment, facing a shifting demand curve because of a changing fashion? Don't forget that the curve can shift backwards as well.

Point of view



Toys 'R' Us has played too long

In the USA, Toys 'R' Us has hit the buffers. After years of dominating the market, the business is no longer performing and its share of the market has fallen to 20 percent. Why has this happened? Competition from giant supermarket chains has led to price cutting, but competing on price has not been enough.

In the USA there is a growing range of specialist shops selling educational and scientific toys. They also catch the market for the latest fashions among more affluent parents – who have money to spend and are in search of a combination of the right toy and the right environment. They choose to shop in bright airy places where assistants have expertise and can give advice. Toys 'R' Us no longer fits the bill.

Your agenda



- 1 Toys 'R' Us has lost market in two directions. Explain these changes using demand curves to show what has happened.
- 2 Why are people prepared to pay more in the new types of shops which are opening up?
- 3 Think of some other products that are being sold in this way.